See also Vol. 3191

No. 18,172.

United States Court of Appeals

For the Ninth Circuit.

ROBERT S. GAYNOR and JANET STONE,
Appellants,

vs.

JAMES L. BUCKLEY, JULIAN N. CHEATHAM, ROBERT B. PAMPLIN, JOHN S. BRANDIS and GEORGIA-PACIFIC CORPORATION,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON.

APPELLANTS' REPLY BRIEF.

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FILED

DEC 17 1962

FRANK H. SCHMID, CLERK

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United States Court of Appeals
For the Ninth Circuit.

Robert S. Gaynor and Janet Stone,
Appellants,
vs.

James L. Buckley, Julian N. Cheatham, Robert B. Pamplin, John S. Brandis and Georgia-Pacific Corporation,
Appellees.

Appeal from the United States District Court for the District of Oregon.

APPELLANTS' REPLY BRIEF.

Statement

Two misconceptions permeate the factual narrative of both briefs submitted by the appellees and becloud the essentially simple issue of the case. These misconceptions are 1) that G-P's charter and the law of Georgia made stockholder consent here really unnecessary, and 2) that the stockholders did not ratify all the terms and conditions of the option. We address ourselves to these.

1. The requirement of stockholder consent.

Our main brief indicated our awareness that, under given circumstances, and as a question of the directors' power under those circumstances, the G-P board might have conferred the option without stockholder approval (PB 14, 34-35)*. We pointed out that the approval of G-P's stock-

* The following abbreviations will be used herein, in addition to those employed in our main brief:

PB —Brief of plaintiffs-appellants.
GPB—Brief of Georgia-Pacific Corporation, appellee.
IDB —Brief of individual defendants-appellees.

holders was necessary for the option here for only one reason, i.e., that the stock with which G-P intended to satisfy the option was to be listed on the New York Stock Exchange. This view is borne out by the proxy statement of G-P and by the testimony of both G-P's counsel and president (PB 7).

The appellees point to various other methods of satisfying the option without securing stockholder approval (GPB 12-16, IDB 6-8, 14-16). The stubborn fact, however, as we pointed out, is that, the G-P management utilized none of the asserted alternatives. Specifically—

a) G-P in fact did not utilize existing treasury stock to satisfy the option. It had none (PB 33).

b) G-P in fact did not proceed to acquire stock in the open market to satisfy the option (id.).

c) G-P in fact did not cancel the conditioned option and replace it with a new one (ibid., 33-34).

d) G-P in fact did not seek a waiver from the Exchange of the requirement of stockholder approval.*

---

* Furthermore, under the terms of the Exchange Manual, G-P could not have received a waiver. According to the Manual it may be possible to obtain a waiver—

> ". . . where options are issued to an individual, not previously employed by the company, as an inducement essential to his entering into a contract of employment with the company." (R 19, lines 8-10)

The conditions were not met because *1*) Brandis had been "previously employed by the company" (PB 3, 4) ; and *2*) the option was not "an inducement essential to his entering into a contract of employment with the company". This is clear from Brandis' deposition testimony (pp. 14-15) concerning the circumstances of the conferral of the option.

Because of its compactness, the paraphrase of the Exchange's requirements for a waiver set forth in 2 Loss, Securities Regulation (1961), quoted at GPB 15, does not fully reflect the conditions to a waiver as set forth in the Exchange Manual and quoted above.

G-P wanted to and did list the optioned stock. Given this objective, stockholder consent was a mandatory necessity, as mandatory as if it had been prescribed by statute or charter.

Furthermore, the requirement of consent supervened any statutory or charter provisions dispensing with consent. The Exchange Manual prescribes stockholder authorization *"regardless of whether or not such authorization is required by law, or by the company's charter"* (R. 18, lines 9-11, PB 8).

2. The scope of stockholder approval.

We pointed out in our brief that the stockholders had ratified the option agreement of February 7, 1956 with Brandis. The appellees assert (GPB 27, IDB 17-18) that the matter submitted to a vote of the stockholders was only the question of ratifying the action of the directors in conferring the option. This hairsplitting confuses the mechanics of the ratification with the substantive action that G-P *A*) was required to take, *B*) that it did take, and *C*) that it asserted it had taken. This substantive action was the approval of the February 7, 1956, option agreement with Brandis which had been authorized by the directors. This agreement contained the conditions which were later extended and thereafter waived.

A. The ratification, it is agreed, stems from the requirement of the New York Stock Exchange. With respect to the substantive action, the Exchange Manual states (R. 18, lines 5-11):

> "The Exchange is of the view that issuance of options to directors, officers or key employees, entitling them to acquire securities of the company, should be authorized by stockholders. Accordingly, stockholders' authorization in respect of options issued to directors, officers or key employees will be a condition prerequisite to authorization of the listing of the optioned

> securities, regardless of whether or not such authorization is required by law, or by the company's charter.

The Exchange's view is thus that the stockholders' authorization must be of the "issuance of options" or "in respect of options", rather than of the action of the directors in conferring them.

With respect to the mechanics of securing approval, the Manual states (R. 18, lines 12-16):

> "Nature of Stockholders' Authorization Required: It will be acceeptable, under Exchange policy, if stockholders give specific authorization for issuance of options to directors, officers or key employees; or if they approve a plan for issuance of options, or if they authorize issuance or reservation of securities for the satisfaction of such options; or take any other affirmative action implementing, or relating to, such options or plan; . . ."

This paragraph enumerates various *methods* by which stockholder authorization may be effected. But, as the Manual makes clear, these are only means to the end. The end at all times is the authorization of the option by the stockholders. This is the substantive requirement of the Exchange with which G-P here had to comply.

B) With respect to the substance of what was actually done by G-P's stockholders, it was conceded by G-P that the stockholders ratified the agreement of February 7, 1956. This was acknowledged by Mr. Pamplin, president and a director of G-P (PB 9):

> "Q. When you sought the ratification of the stockholders, you sought the ratification of the terms of the option, didn't you, that was entered into, the terms of the option agreement that was entered into?
>
> "A. I would say that's right." (T. 40)

That no stockholder may have availed himself of the opportunity to examine the option agreement at the meeting (GPB 29-30) is of less moment than the fact, as Mr. Pamplin testified, that on request a stockholder would have been afforded the opportunity (T. 40, PB 9), for it shows what it is that G-P conceived that the stockholders were passing upon.

C. With respect to what G-P itself asserted it had done, we noted in our main brief that subsequent to the stockholders' meeting, G-P filed with the S.E.C. and the Exchange, in a "current report" on Form 8-K, the full text of the option agreement, in response to an instruction that there be filed a copy of the text of the proposal submitted to a vote of the stockholders (PB 9-10). If, as the appellees now earnestly profess, the matter submitted to a vote of the stockholders was merely the grant of the option, without reference to the conditions of its continuing in force, there was no reason for filing the full text of the agreement.

G-P's brief here is utterly silent concerning the officially prescribed filing of the full text of the option agreement, and the significance of such filing for the appellees' contentions. The brief of the individual appellees (IDB 17-18), however, lists the 8-K Report among the documents which, the appellees contend,

> ". . . establish that the option agreement was not submitted, that no reference was made to the conditions in paragraph 15, and that the submission was made for the purpose of securing ratification of the Board's action in granting the option *as described in the proxy statement.*" (Emphasis in original.)

Since the full text of the option agreement was filed in the 8-K Report, this statement is incomprehensible.

ARGUMENT

POINT I

Modification by the directors of the option agreement with Brandis was invalid for lack of stockholder approval.

In our main brief (pp. 20, *et seq.*) we cited various authorities, in the field of executive compensation and elsewhere, showing the paramount power of the stockholders with respect to corporate action authorized by them, and the lack of power of the directors thereafter to deviate from authorization thus conferred.

Corroboration of this view is further afforded by *Texas Co.* v. *Z. & M. Independent Oil Co., Inc.,* 66 F. Supp. 957 (N.D.N.Y. 1945). There, by an agreement of September 20, 1929, Z & M granted an option under which Texas could acquire all of its property. One of the methods of determining the price was to be an appraised fair value, the agreement setting forth standards of appraisal for the realty and for the personalties. On September 18, 1929 the Z & M directors had authorized the execution of the option agreement. By law stockholder approval was required, and on September 23, 1929, it was obtained.

In February, 1930, Z & M, without stockholder approval, agreed to a change in the prescribed method of appraising the personalties (66 F. Supp. at 961).

In 1944 Texas sought to exercise the purchase option, and Z & M asserted that the option agreement was invalid on various grounds. Concerning the February, 1930 change in the method of appraisal, Texas advanced a contention echoing that of the appellees here (66 F. Supp. 966):

> "Plaintiff [Texas] urges that inasmuch as the resolution of the stockholders did not prescribe the manner

in which the properties were to be appraised or the standard of valuation to be used therein, such change was merely a change in detail which the stockholders left to the discretion of the officers of the company, and that such change was fully within the stockholders' authorization.''

The court rejected this contention. Holding the modification invalid, the court stated (*id.*),

> ''Having exercised their authority under the stockholders' resolution, the officers had no further power. Their authority was exhausted. The power to execute and deliver a contract does not imply authority to modify it. The attempted modification of the option agreement of February, 1930 is ineffective. *Dudley* v. *Perkins,* 235 N. Y. 448, 139 N. E. 570 [1923].''

Neither side challenged this ruling on appeal, 156 F. 2d 862 (2d Cir., 1946), at 864, note 1, where the ruling of the district court was in other respects affirmed.

The case thus holds, in accord with our position, that where stockholder consent to an agreement is required and secured, the agreement may not thereafter be changed without their consent. No residual authority to change the agreement remains.

We may add that the ruling, especially in view of its reliance on *Dudley* v. *Perkins,* corroborates the position, advanced in Point III of our main brief (PB 38-42), that the law of agency prohibited G-P's directors from departing from the terms of the option agreement. The casual dismissal of this contention by the appellees (GPB 31, IDB 27) obviously is in error.

Appellees' principal reliance for their proposition that the extension and waiver here could be validly authorized by the directors without stockholder approval is on two cases, *Beveridge* v. *N.Y.E.R. Co.,* 112 N. Y. 1, 19 N. E.

489 (1899), and *Amdur* v. *Meyer,* 15 A. D. 2d 425, 225 N.Y.S. 2d 440 (1962). *But in both these cases, the directors' modifications were approved by the stockholders.* Despite extensive analysis of and quotation from the cases, both briefs of appellees overlook this fact.

Appellees' reliance on *Beveridge,* furthermore, is made possible only by their perpetuating the misapprehension which pervades their briefs throughout. They persist in ignoring the fact that the G-P board here, deliberately and with full awareness, followed a course of conduct which made resort to stockholder authorization essential "whether or not such authorization is required by law, or by the company's charter", as the Exchange Manual prescribes.

In *Beveridge,* there was no requirement of any sort that stockholder authorization be obtained for the tripartite agreement of May, 1879, under which New York's properties were leased to Manhattan. Legislation of 1839, the court held, had been construed to dispense with stockholder concurrence, 112 N. Y. 21-22, 19 N. E. 493-4. While the securing of such concurrence by the directors was held to be "a very proper and reasonable precaution to take," 112 N. Y. 24, 19 N. E. 495, it was not a condition to the validity of the method chosen to effectuate the directors' objective. Since the stockholder's initial concurrence there was thus legally gratuitous, the court after discussion concluded that stockholder concurrence in the later lease modification of October and November, 1881, was not necessary. 112 N. Y. 27, 19 N. E. 497. In view of the actual ratification there, however, the discussion was obviously not necessary to its decision.

While the *Beveridge* case thus proceeds in a factual and legal setting different in a basic respect from the present one, we may note a further factor rendering the language of the Court inapplicable to the present situation. A principal ground of the decision was that the obliga-

tion in suit did not run to the plaintiff individually, and that he therefore lacked standing to bring the action at all. 112 N. Y. 24-27, 19 N. E. 496.

Finally, as has been noted, even the 1881 modifications which the plaintiff challenged also received stockholder approval, at a meeting in January, 1882. 112 N. Y. 17, 19 N. E. 492. In the present case, the lack of stockholder approval for the modifications is precisely the gravamen of the suit.

It is of significance that while appellees seek to read into the *Beveridge* case a ruling that stockholder-approved action may be modified by directors without further stockholder action, the case has never been cited as authority for this proposition.

Amdur v. *Meyer,* 15 A. D. 2d 425, 224 N.Y.S. 2d 440 (1962), is made to support the appellees' position only by means of an utterly unwarranted interpolation by them into the court's opinion.

As was earlier noted, the directors' alteration of the terms of an option agreement was confirmed "by an overwhelming vote" of the stockholders. 224 N.Y.S. 2d 442. Since stockholder ratification had been given, there was no need for the Court to consider any contention that the modification was ineffective without stockholder ratification, and the court did not in fact pass upon it. The contentions of the complainants on which the court did pass were set forth in the opinion. The opinion said (224 N.Y.S. 2d 442-443):

> "Respondents contend that the directors by the adjustment made a gift to the optionees which was not contemplated by the provisions of the original agreement. They submit that the directors under the guise of interpreting the agreement in fact amended the document. They argue that the action taken was a subterfuge because amendment of the agreement would

> have presented tax problems and would have required revelation in proxy and annual statements.''

This was the sum total of the complainants' contentions to which the Appellate Division addressed itself. It immediately proceeded to state (224 N.Y.S. 2d 443),

> ''We find no merit to respondents' contentions in the light of the facts presented. Neither do we find it necessary to determine whether the 1958 action was an 'interpretation', 'construction' or 'modification' of the basic agreements . . .''

In our case, the individual appellees do not set forth the above-quoted contentions in their brief. Instead, they seek to give their own connotation to the conclusion of the Appellate Division by inserting a question raised by the *Amdur* complainants, but one to which the court did not address itself (IDB 22). The question put by the *Amdur* complainants was: After stockholder approval was obtained for the initial option plan,

> ''Could the directors thereafter, without action on the part of the stockholders or notification to them, amend the option agreements to provide additional benefits?'' (Quoted at IDB 22).

After quoting this question, the brief of the individual appellees here proceeds to state (IDB 22),

> ''The Appellate Division reversed the lower court, directed judgment for the defendant and dismissed the complaint, saying (224 N.Y.S. 2d at 443):
>
> '' 'We find no merit to respondents' contentions in the light of the facts presented. . . .' ''

By interpolating the *Amdur* complainants' question immediately before it recites the Appellate Division's reversal and the quotation beginning ''We find no merit to re-

spondents' contentions . . .'' the individual appellees' brief makes it appear that the Appellate Division was rejecting the contention, posed by the quoted question, that the directors could not amend the option agreement without stockholder approval. But the Appellate Division passed on no such contention. The fact that the stockholders had approved the modifications rendered the question totally moot.

Indeed, the consent of the stockholders to the modification made the Amdur complainants resort to the extreme position that the plan amendment constituted ''a gift to the optionees'' (224 N.Y.S. 2d 442, quoted above, p. 9), which not even majority stockholder ratification could confirm (224 N.Y.S. 2d 444). The Appellate Division, holding that it was within the directors' competence to determine that in the light of the dilution of the optionees' stock interests, ''the basic agreement did not convey the benefits the directors had originally intended to confer,'' (224 N.Y.S. 2d 443), concluded that there was no showing that the defendant-director was acting other than according to his best judgment, ''which was subsequently confirmed by the stockholders'' 224 N.Y.S. 2d 443. It held therefore that the action did not constitute a gift (224 N.Y.S. 2d 444). This is a far cry from the present case.

G-P (GPB 18) cites also *Petrishen* v. *Westmoreland Finance Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959), but its relevance to the present situation is not evident. The case involved a departure by the board of directors from the terms of an agreement previously approved by the board of directors. It did not involve a departure by the board of directors from the terms of a corporate step ratified by stockholders, and certainly not from the terms of a corporate step for which stockholder ratification was required. According to the opinion, 147 A. 2d 394,

> ''This agreement was approved and ratified by *all* of the directors, who at that time also constituted *all*

> of the corporation's stockholders.'' (Emphasis in original.)

The directors thereafter issued stock on terms not conforming to those in the agreement, and this action was sustained by the court.

Independent corroboration of this reading of the case appears in ''1959 Annual Survey of American Law—Business Organization'', 35 N.Y.U.L. Rev. 613 (1960), at 634:

> ''Another familiar statutory provision that no stock shall be issued 'except for money, labor done, or money or property actually received' has been interpreted by the Supreme Court of Pennsylvania not to invalidate the *directors'* promise at the time of employment, to issue stock in the future to a key employee, and later to waive a condition that the stock shall be issued only when the earnings of the corporation reach a certain level.'' (Emphasis added.)

It was a condition of ''the directors' promise'' that was waived, not the stockholders'. The case does not reach the problem with which we are here concerned, the power of directors to modify and waive stockholder-authorized action.

The attempts of the appellees to distinguish *Gottlieb* v. *Heyden Chemical Corp.,* 33 Del. Ch. 82, 90 A. 2d 660 (Sup., 1952), on reargument, 33 Del. Ch. 377, 91 A. 2d 57 (Sup., 1952), are without merit. Their effort is based upon the language of the opinion stating that at the time of the stockholders' meeting the option contracts had already been executed, and that as of that date

> ''. . . neither party alone could alter rights under the contracts . . .'' 90 A. 2d 665.

This passage, the appellees claim, holds that, as to executed bilateral contracts, amendments could be made

only by agreement of both parties thereto, and they deny that the case holds that amendments by the directors and the optionees required stockholder approval (IDB 25, GPB 23).

That changes in executed option contracts require the consent of the optionees is elementary. But this was not the question before the court. The question, as we stated in our brief, was whether the stockholders' ratification was illusory because the directors had the power to amend, and it assumed the optionees' consent.

This question the court twice answered in the negative. See the discussion in appellants' brief (PB pp. 22-23). Appellees' error stems from their view that it was the directors who were one of the contracting parties, instead of recognizing that it was the corporation that is the party. Once this fact is recognized, the discussion in our brief shows that the directors could not amend on behalf of the corporation (even with the consent of an optionee) unless the amendment was approved by the stockholders. Any other construction of the court's opinion renders it meaningless.

In *Winkelman* v. *General Motors Corp.*, 44 F. Supp. 960 (S. D. N. Y., 1942), with respect to the stockholder-approved Managers Securities plan, the court did not say that the change in date, agreed to on behalf of General Motors by Mr. Sloan, would have been valid if the change had been approved by the board of directors. It specifically stated, as our brief pointed out (PB 25):

> "If a change in date was desirable an amendment of the plan should have been submitted to the stockholders for their approval." 44 F. Supp. 977.

The requirement of stockholder approval for bonus plan amendments in the *Winkelman* case, notwithstanding the reserved power of the directors to amend, was discussed in our main brief (PB 25).

On an analysis of all the cases, the appellees' as well as the appellants', it is clear that when stockholder ratification is a prerequisite to corporate action and is obtained, ratification is likewise required for any alteration or modification of such action.

POINT II

The ratification by the stockholders extended to the entire agreement.

Our main brief expressed the view that the stockholders' ratification of the option agreement was entire and included the ratification of the conditions under which the option would be extinguished (PB 37-38).

In response, the appellees first take the position that the ratification extended only to that portion of the agreement which conferred the option (IDB 18, GPB 26). They cite no authority for such partial ratification.

Apparently realizing the weakness of this position, they appear also to contend that the stockholders could not ratify a contract containing undisclosed conditions, and that consequently there was no ratification (IDB 18, GPB 30).

This position essentially asserts that the management was free to withhold terms of the agreement from the stockholders in seeking ratification; proceed to use the ratification for the purpose of obtaining a listing of the stock; attest to the S.E.C. in an 8-K report that the ratification covered the entire agreement; and then, in this case and for the purpose of justifying the modification of the terms of the agreement without stockholder approval, assert the management's own non-disclosure to demonstrate that there had been no initial ratification. They conclude from all this that no ratification of the later extension and waiver was necessary. They thus assert their own deliberate non-disclosure as conferring upon themselves greater powers than if they had fully disclosed.

This argument puts a premium on deliberate concealments by the management in order to enhance its own power vis-a-vis the stockholders. It should not be countenanced by a court of equity.

Appellees, in addition, ignore a familiar tenet of what constitutes the scope of authorization and ratification, both of which, as we have seen (PB 38), are governed by the same principles of law. Cf. Cal. Civ. Code, § 2310.

According to 1 A.L.I. Restatement of Agency 2d (1958) § 58:

> "AUTHORITY TO MAKE UNSPECIFIED TERMS. Unless otherwise agreed, the specification of particular terms in an authorization to buy or to sell does not exclude authority to make additional terms not inconsistent with those prescribed, *nor terms which diminish the duties or increase the rights of the principal* beyond those specified." (Emphasis supplied.)

See also:

> *Witherell* v. *Murphy,* 147 Mass. 417, 18 N. E. 215, 216 (1888).

Thus, in the present case, the ratification of the 8-year option also ratified the conditions under which the option could be terminated sooner and G-P could supply less stock than the full option required. These conditions diminished the obligations of G-P and increased its rights, and the conditions were therefore embraced within the scope of the ratification. Thus the contentions of the appellees fall, because they are based upon the incorrect premise that in the absence of disclosure, the conditions were not ratified.

Conclusion

This is a case of first impression in this Court. We do not believe the Court should let stand a ruling which violates a fundamental right of corporate stockholders, and which sanctions a management device for increasing management power by means of non-disclosure to the true owners of a corporation.

The judgment below should be reversed.

December, 1962.

Respectfully submitted,

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Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Sidney L. Garwi